

Internal Revenue Service
memorandum

CC:TL-N-7333-89

TS/LJBYUN

date: JUN 19 1989

to: District Counsel, Los Angeles, W:LA
Attn: Joyce Sugawara

from: Acting Senior Technician Reviewer
Tax Shelter Branch CC:TL:TS

subject: [REDACTED]

This is in response to your request for tax litigation advice dated June 1, 1989, regarding a Scar issue in the above mentioned case.

ISSUE

Is the statutory notice of deficiency in this case valid under Scar v. Commissioner, 814 F.2d 1363 (9th Cir. 1987)?^{1/}

CONCLUSION

We recommend that the case be conceded based on the Scar holding.

FACTS

A statutory notice of deficiency was issued to the [REDACTED] on [REDACTED], for the tax year [REDACTED]. The statutory notice specified a deficiency in the amount of \$ [REDACTED] arising from disallowed losses in the amount of \$ [REDACTED] from [REDACTED].^{2/} The statutory notice used language similar to the "smoking gun language" of Scar. It stated: "In order to protect the government's interest and since your original income tax return is unavailable at this time, the income tax is assessed at the

^{1/} We note that in the petitioner's Motion for Dismissal for Lack of Jurisdiction which is attached to this request, one of the basis for seeking dismissal is that this statutory notice constitutes an invalid second statutory notice under section 6212(c). Since advice on this issue is not requested, only the Scar issue is being addressed herein.

^{2/} On their [REDACTED] return, the [REDACTED] did in fact claim a loss of \$ [REDACTED] with respect to [REDACTED].

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maximum rate."^{3/} Attached with the submission is a transcript of account for the [REDACTED] year dated [REDACTED]. Notwithstanding the apparent availability of the transcript of account, the only information taken from the transcript of account in computing the deficiency was the tax shown on the return and not also the AGI or taxable income.

Since this case lies within the Ninth Circuit, we recommend that the assessment be conceded based upon the Scar holding. Although the Service does not agree with the Ninth Circuit's "substantive content" standard for testing the validity of deficiency notices under section 6212(a), as a result of the uncertainty of the scope of Scar, the Service wants to restrict the impact of the decision to the facts in that case. Therefore, the Service will not relitigate the "determination issue" on facts not materially different from Scar.

It is our position that we do not need to have the original return to make a determination. Instead, we can rely on taxpayer return information found in the transcript of account, as well as relevant K-1s. Since it is our position that we can rely on the Service's data bases to make a determination, it is imperative that we actually use the information from the transcript to make the determination, as compared to "backing into" the deficiency. If we use the amount shown for AGI or taxable income from the transcript, as well as the amount shown for tax on return, plus the other information regarding the adjustments, a proper determination can be made.

Although this case is distinguishable from the facts of Scar, this is not the type of case that we want to defend in the Ninth Circuit since it does not involve facts that justify application of our theory that a proper determination can be made by using relevant information from our data bases.

Here, the right adjustment was made (i.e., right shelter and right amount) but the deficiency was backed into with a plug rate of 70% incorrectly applied.^{4/} The Service failed to use all the relevant information that was available when the determination was made. Moreover, the deficiency notice contained the "smoking gun language". With respect to this last point, we note that

^{3/} The maximum rate that was applied was 70%.

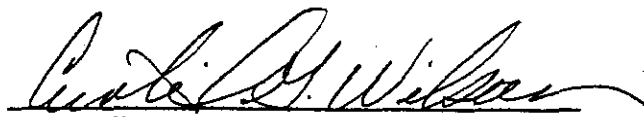
^{4/} For [REDACTED], the tax imposed on a joint return with a taxable income of \$[REDACTED] (i.e., \$[REDACTED] (taxable income shown on the return) + \$[REDACTED] (amount disallowed) = \$[REDACTED]) was \$[REDACTED] plus [REDACTED]% of the excess over \$[REDACTED].

recently, the Ninth Circuit in Clapp v. Commissioner, No. 88-7083, slip op. at 5517 (9th Cir. May 24, 1989), while limiting the scope of Scar, reiterated its position that the Commissioner is required to prove that a determination was made if the deficiency notice, on its face, shows that a determination was not made. The Court stated:

Furthermore, as the Tax Court has since pointed out, Scar did not even require any affirmative showing by the Commissioner that a determination set forth in an alleged notice of deficiency was made on the basis of the taxpayers' return. Only where the notice of deficiency reveals on its face that the Commissioner failed to make a determination is the Commissioner required to prove that he did in fact make a determination. Campbell v. Commissioner, 90 T.C. 110 (1988). Here, nothing on the face of the notice reveals that the Commissioner failed to make a determination.

Because, in this case, we did not use all the relevant information (i.e., such as taxable income or AGI) that was available when the deficiency was determined, it does not meet the requirements for application of our theory that a proper determination can be made by using relevant information from our data bases. Therefore, this is not the type of case that we want to defend in the Ninth Circuit.

Based upon the above facts, we do not recommend defending this case. Should you have any further questions regarding this matter, please contact Lisa Byun at FTS 566-3289.


CURTIS G. WILSON